

Ukraine's accession to the Energy Community Treaty: implications for all parties

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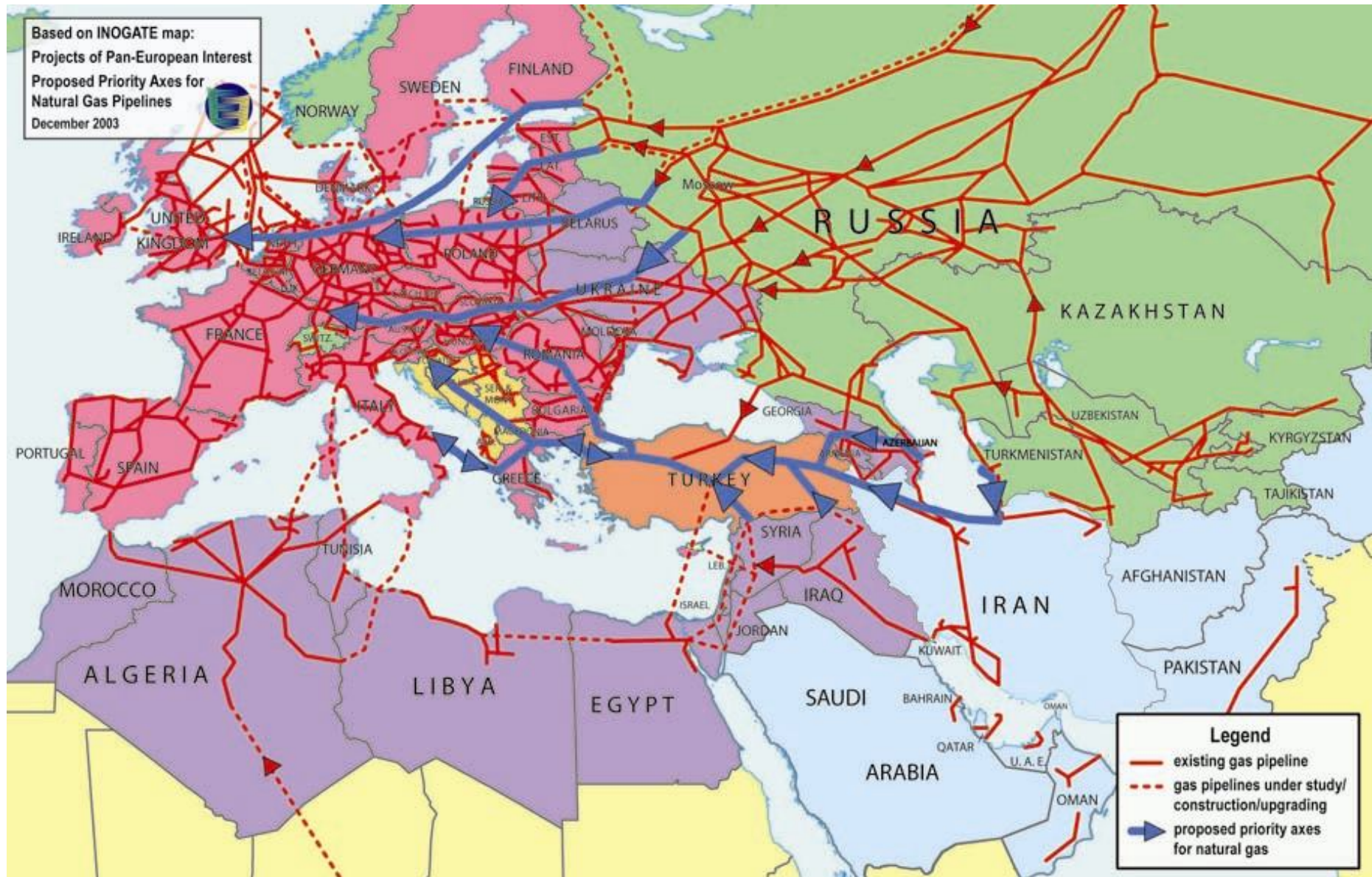
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- **Energy Community Treaty & its place in EU's "export of acquis» policy**
- Ukraine & myths on consequences of accession to Energy Community Treaty
- How EU gas market would be organised:
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- Myths & realities on EnComTreaty consequences for Ukraine & other parties

Energy Community Treaty as part of EU's "export of *acquis communautaire*" policy

- For EU, harmonization of EU legislation with legal systems of third states means basically application of EU legislation within these third states, incl. in energy => "export of *acquis*"
- EU tries to expand geographical area of implementation of *acquis* in energy (umbrella policies => soft law => hard law):
 - Hard / overall: EU enlargement (EU15 => EU25 => EU27 => EU27+ ?)
 - Hard / sectoral (energy):
 - Strengthening: Third EU Energy Directives (2009) => "Third party clauses"
 - Expansion: EU-SEE Energy Community Treaty (EU27+7) + new observers/members (incl. Ukraine)
 - Soft: EU Neighborhood Policy (EU27 + 10NA + 6FSU/CIS, incl. Ukraine)
 - Umbrella: EU Eastern Partnership (6FSU/CIS, incl. Ukraine)

Export of EU's acquis policy (map)



Export of EU's acquis policy (legend)

Zone	States within the zone	Description
	EU Members: 27 EU countries	EU legislation, including the energy legislation, is fully applicable
	Energy Community EU-SEE Countries: Croatia, Serbia, Montenegro, Bosnia, FYROM (Macedonia), Albania, UNMIK (Kosovo); other Energy Community members are already EU members	Only EU legislation on internal electricity and gas markets is applicable
	EU Candidate Countries: Turkey (Croatia is already an Energy Community member so applying the EU energy market acquis)	Still in the process of alignment to the EU legislation but full compliance not likely before membership
	EU Neighbourhood Policy Countries: FSU/CIS (Armenia, Azerbaijan, Belarus, Georgia, Moldova, Ukraine = EU Eastern Partnership) and Northern Africa (Algeria, Egypt, Israel, Jordan, Lebanon, Libya, Morocco, the Palestinian Authority, Syria, Tunisia)	Enhanced energy cooperation based on National Action Plans with Ukraine and Moldova (as well as with Israel, Jordan, Morocco, the Palestinian Authority and Tunisia); partial application of EU energy policies and legislation may be possible in the future

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Few myths on consequences of Ukraine's accession to the Energy Community Treaty

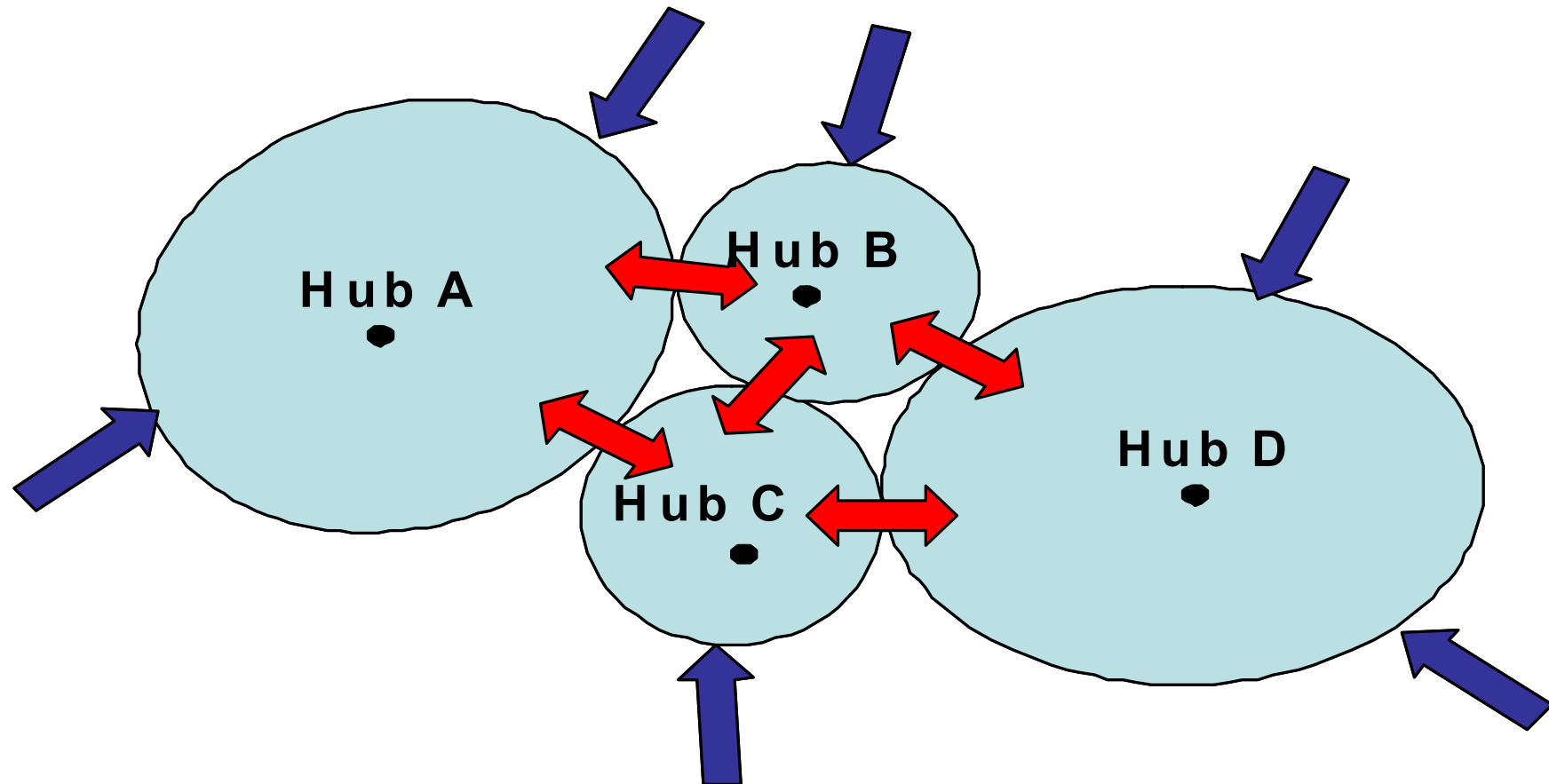
- No long-term supply contracts any more
- No formula pricing any more
- No long-term transit contracts any more
- Delivery points of Russian gas to the EU to be moved to eastern border of Ukraine

=> To understand how EU gas market will work

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Future organization of common internal EU gas market according to 3rd EU Energy package (1)



Source: 17th Madrid Forum (Jan'2010), Energy Regulators of EU member-states

Future organization of common internal EU gas market according to 3rd EU Energy package (2)

- Currently in the making (12 Framework Guidelines + 12 Technical Codes to make Directive 2009/73/EC & Regulation 715/2009 workable)
- No single EU gas market in the near future even as a model
- All market areas to be organized as **entry–exit zones** with **virtual hubs** => Towards uniform capacity allocation mechanisms & gas pricing mechanisms, but:
 - Gas pricing at the hubs: on **all** gas volumes **or** just on a **portion** of gas supplies? And when?
 - Capacity allocation: **short**-term vs. **long**-term? At zones borders?
 - Whether Ukraine's gas system is technically, economically & legally ready for & should move to this model at domestic market after accession to Energy Community Treaty?

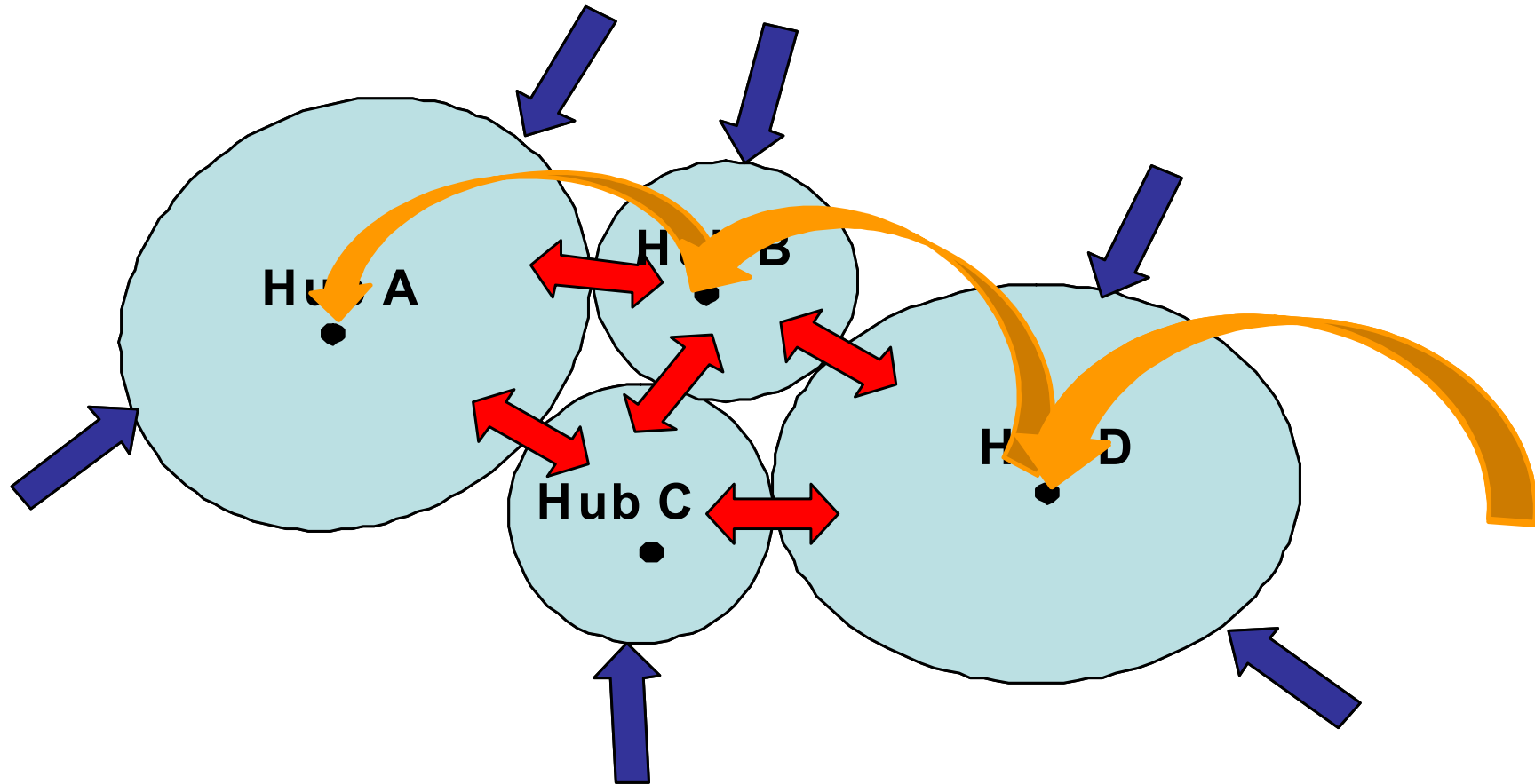
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EU gas market areas: how they will work (EREG view)

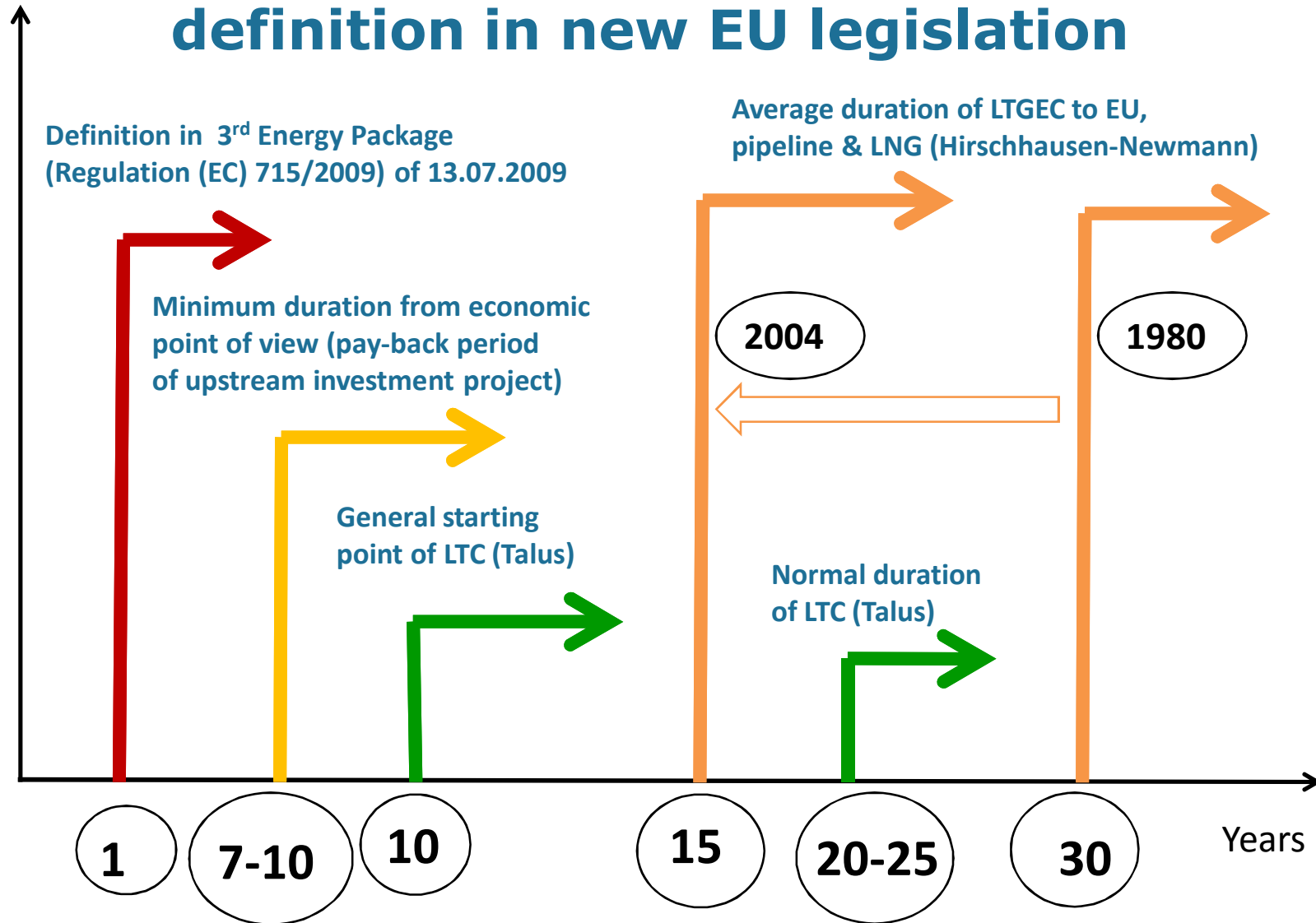
- All EU territory would be divided into market zones with entry-exit tariffs; each zone will have its liquid virtual hub. In the future all the trade will be concentrated on liquid virtual hubs – and on-border trade would be liquidated. Hubs will become delivery points for gas supplies within historical LTGEC, but this will not influence pricing mechanism within LTGEC since hub for LTGEC will become only a delivery point.
- All interconnection points between neighbouring zones will be integrated into one single contractual entry-exit point between the market zones. For transportation between the zones it would be enough to nominate for entry in one zone and for exit in another zone.
- Transportation would be undertaken by shipper purchasing such amount of packages of bundled capacity products, which would be enough to deliver gas to the hub of the zone where final buyer is located (to deliver gas to buyer placed at hub A it would be necessary to purchase two packages of bundled products: first between hubs A & B, second – between hubs B & D).

Future organization of common internal EU gas market according to 3rd EU Energy package (3)



Source: 17th Madrid Forum (Jan'2010), Energy Regulators of EU member-states

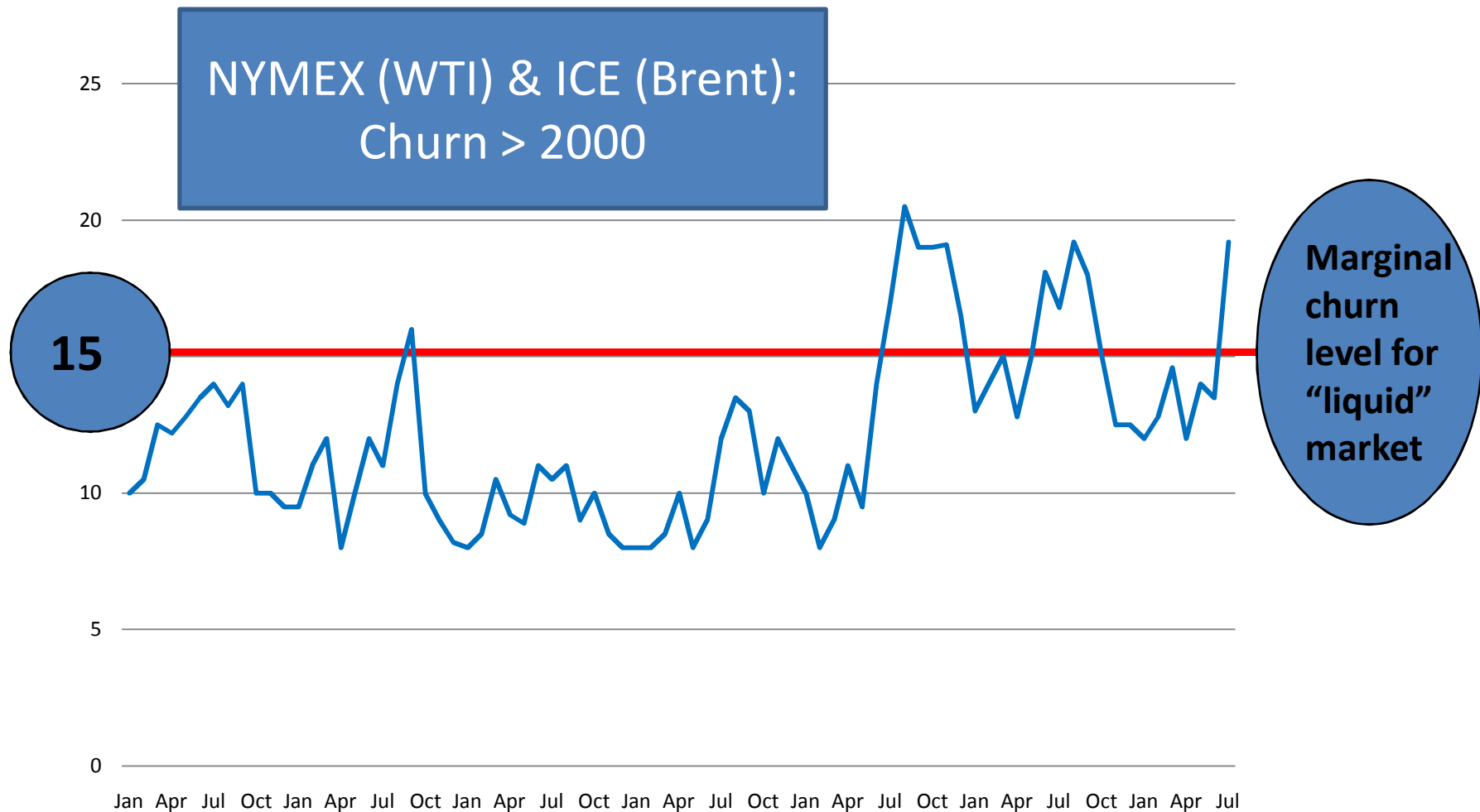
Long-term gas (export) contracts: different duration in historical European practice & definition in new EU legislation



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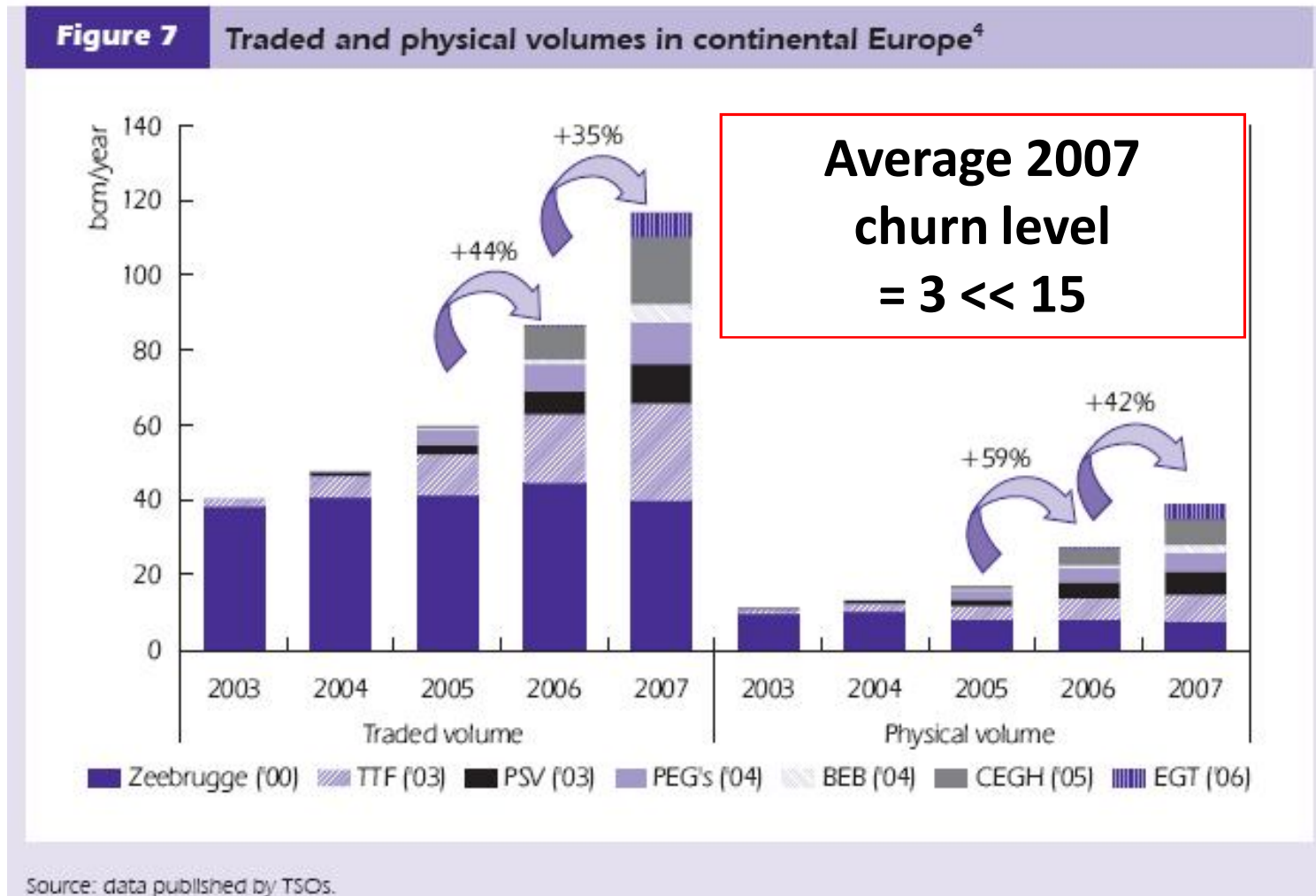
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NBP (UK) churning factor, 2003-2009



Source: NBP - "Gas Matters" for corresponding years, WTI/ICE – M.Kanai estimate

Traded and physical gas volumes in continental Europe (w/o NBP)



Source: IEA. Natural Gas Market Review 2008, p.32

Evolution/adaptation of gas pricing mechanisms in Europe: two main options

- **Option 1:** to substitute gas price indexation in LTGECs by spot/futures quotations => **NO**
- **Option 2:** to adapt mostly oil-linked gas price indexation in LTGEC by pricing formulas linked to broader spectrum of parameters & non-oil gas replacement values => **YES, but** long-term capacity allocation **must** be available to exclude contractual mismatch problems - supply vs. transportation:
 - **Long-term supplies (basic/base-load)** : more flexible LTGEC (n x 1 year) + “modified” gas replacement value formulas (price indexation **not** limited to oil-pegging);
 - **Short-term supplies (supplementary/peak- & semi-peak load)** : short-term (< 1 year)/spot contracts + futures quotations

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Few myths on consequences of Ukraine's accession to the Energy Community Treaty – and the realities

- No long-term supply contracts any more?
 - LTGEC will stay though more flexible
- No formula pricing any more?
 - Formula pricing within LTGEC will stay though modified (deviation from oil-pegging)
- No long-term transit contracts any more?
 - Long-term capacity allocation will be still possible (based on open season procedure)
- Delivery points of Russian gas to the EU to be moved to eastern border of Ukraine?
 - No. Delivery points will stay where buyer & seller of the gas will agree on them (at hubs inside the EU)

**Thank you for your
attention !**

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